

Before The
North Carolina Utilities Commission
South Carolina Public Service Commission

In The Matter Of: Duke Power, a Division of Duke Energy Corporation

Affidavit of Martin J. Coe

Martin J. Coe deposes and says:

- 1 I am a resident of Illinois, over the age of eighteen (18), and I am competent to testify about the matters contained in this affidavit based on my knowledge and expertise in regulatory utility accounting.
2. I have been engaged by Grant Thornton to provide an expert assessment of Duke Power's accounting treatment of distributions it received in 1998, 1999, and 2000 from the nuclear mutual insurance entities, Nuclear Mutual Limited (NML) and Nuclear Electric Insurance Limited (NEIL).
3. I received a bachelor's degree in accounting in 1984 and a masters degree in business administration in 1992 from St. Ambrose University in Davenport, Iowa.
4. I received my initial Certified Public Accountant (CPA) license in 1990 in Illinois and have maintained my license to practice public accounting in Illinois since that date. I am also a certified management accountant (CMA), a certified government financial manager (CGFM) and a certified information systems auditor (CISA).
5. I have continued my professional education and development by completing all required continuing professional education requirements to maintain my professional licenses, certificates and membership in professional associations.
6. I am a member of the American Institute of Certified Public Accountants, the Illinois CPA Society, the Institute of Internal Auditors, the Institute of Management Accountants, and the Information Systems Audit and Control Association. I have been a member of several utility industry groups including serving as chairman of the Missouri Valley Electric Association Plant Accounting Division.
7. I am an assistant professor of accountancy for Western Illinois University (WIU). I have taught upper-class and graduate level accounting courses at WIU since 1993. WIU's accounting program is highly regarded as evidenced by its accounting accreditation from The International Association for Management Education. My position includes research and publication responsibilities. My current scholarly research is in the area of regulatory utility accounting.
8. From 1984 and until I joined the faculty at WIU and formed my consulting practice in 1993, I held positions with The Kartridg Pak Company, Iowa-Illinois Gas and

Electric Company and Rochelle Utilities. From 1988 to 1993 I held several utility accounting management positions ranging from accounting supervisor to chief financial officer. I was responsible for the interpretation of and compliance with state and federal regulations and the Uniform System of Accounts (USOA). I represented the companies at the local, state, and national level. I also prepared expert testimony in rate-related matters in Iowa and Illinois.

9. Since 1993, I have delivered utility consulting services in the areas of utility accounting, finance and information systems. In addition to project-specific engagements with investor-owned and public power electric utilities, I have developed and delivered utility accounting training courses for the American Public Power Association since 1993.

10. My publications include:

Edited Utility Accounting - an American Public Power Association Education Course Manual copyright 1995.

Authored Advanced Utility Accounting - an American Public Power Association Education Course Manual copyright 1998.

Authored Utility Accounting Principles - a Tennessee Valley Public Power Association Education Course Manual copyright 2000.

Authored Utility Account Classification, Work Order, Inventory and Plant - a Tennessee Valley Public Power Association Education Course Manual copyright 2000.

Authored Budget, Finance and Accounting for Utility Executives - a Tennessee Valley Public Power Association Education Course Manual copyright 2000.

Authored Using Enterprise Resource Planning Systems as the Core of an Integrated Accounting Information Systems Course - published in the *Review of Business Information Systems*, Volume 5, Number 4, Fall 2001.

1. My opinion is based on my education, experience, familiarity with regulated utility industry practices, my review of Grant Thornton's findings regarding accounting entries, the Report Submitted by Duke Power (Duke) to the NCUC and SCPSC on August 28, 2001, which included surveillance reports Duke provided to the NCUC and SCPSC. I also reviewed public documents located on the NCUC and SCPSC websites.
12. Duke has/had property, business interruption and workers compensation insurance with Nuclear Mutual Limited (NML), Nuclear Electric Insurance Limited (NEIL), American Nuclear Insurers (ANI) and Mutual Atomic Energy Liability Underwriters (MAELU) for its three nuclear power plants: Oconee, McGuire and Catawba. Duke

Power is a joint owner (12.5%) of the Catawba facility with several other municipalities and other utilities. Duke receives annual distributions (refunds) from these mutual insurance carriers for positive experiences over the life of these contracts.

13. Duke paid premiums to NML for primary property insurance on its nuclear facilities. The gross amounts of the premiums were set-up as part of prepaid insurance and amortized to expense accounts equally each month over the policy period. The primary property insurance premiums for Oconee and McGuire, and 12.5% of the Catawba premiums were expensed to account 924.98 – property insurance, an above the line utility operating account.
14. Duke received annual refunds from NML for previous insurance premium payments due to positive historical experience. Prior to 1998, the refunds from NML for primary property insurance were credited to account 228.11 – nuclear property insurance reserve, a balance sheet account. 100% of the refund from premiums paid for the Oconee and McGuire facilities and 12.5% of the distribution for Catawba were credited to this reserve account. In 1997, the aggregate amount credited to this reserve account for NML refunds was \$8,306,867.
15. In 1998, Duke's NML refunds (\$8,659,803) were initially credited directly against property insurance expense, account 924.98. In December 1998, \$8,659,803 relating to these NML refunds were adjusted out of account 924.98 to account 421.31 – sundry revenues, a below the line miscellaneous income account.
16. Duke has secondary property insurance and business interruption insurance with NEIL. The gross amount of the premiums was set-up as part of prepaid insurance and amortized to expense equally each month over the policy period. The primary property insurance premiums for Oconee and McGuire, and 12.5% of the Catawba premiums were expensed to account 924.98 – property insurance, an above the line utility operating account.
17. Duke received annual refunds from NEIL for positive historical experience. Prior to 1998, these refunds were recorded as a credit directly against the premiums in account 924.98. The refunds from premiums paid for the Oconee and McGuire facilities and 12.5% of the refunds for Catawba were credited to this expense account. In 1997, refunds of \$10,799,795 remained above the line as a reduction of property insurance expense account 924 in the Federal Energy Regulatory Commission (FERC) Form 1.
18. In 1998, the NEIL refunds (\$15,728,013) were initially recorded in the same manner as they had been in prior fiscal years. In December 1998, \$15,728,013 of NEIL refunds were adjusted to account 421.31 – sundry revenues, a non-operating miscellaneous income account, below the line. In 1998, the \$15,728,013 was recorded as a component of other non-operating income below the line in the FERC

Form 1, and were not included in net utility operating income in the quarterly filings with the NC and SC Utilities commissions.

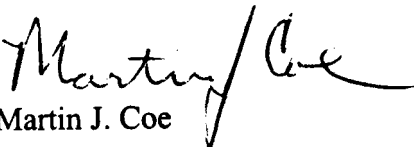
19. Duke has additional insurance with two other carriers, American Nuclear Insurers (ANI) and Mutual Atomic Energy Liability Underwriters (MAELU). These carriers provide insurance for the three nuclear facilities. The insurance premiums for Oconee and McGuire, and 12.5% of the Catawba premiums were expensed to account 924.98 in 1998 – property insurance, an above the line utility operating account. In 1998, Duke received refunds (\$2,103,492) from these carriers. Initially, 100% of the distribution from premiums paid for the Oconee and McGuire facilities and 12.5% of the distribution for Catawba were credited to account 924.98 – property insurance (above the line). In December 1998, the entire \$2,103,492 of these refunds were adjusted to account 421.31 – sundry revenues (below the line), and remained as a component of other non-operating income in the FERC Form 1, and were not included in net utility operating income in the quarterly filings with the NC and SC Utilities commissions.
20. In 1999, Duke recorded the refunds, net of Catawba's portion, to account 421.31, sundry revenue. These amounts were initially posted to account 924.98, then adjusted in the same month to the below the line miscellaneous revenue account (421.31). The amount adjusted to miscellaneous income 421.31 was \$22,903,646. This \$22,903,646 is included in miscellaneous non-operating revenue on the 1999 FERC Form 1, page 117, line 37 balance of \$96,544,259.
21. In 1999, Duke's ANI/MAELU refunds of \$438,247 were classified as miscellaneous non-operating revenue in the 1999 FERC Form 1, page 117, line 37 balance of \$96,544,259.
22. In fiscal 2000, refunds totaling \$33,940,808, were classified as non-operating sundry revenues in account 421.31 below the line. The \$33,940,808 is included in miscellaneous non-operating revenue below the line on the 2000 FERC Form 1, page 117, line 37 balance of \$85,035,905.
23. In 2000, Duke's ANI/MAELU refunds of \$651,693 were classified as miscellaneous non-operating revenue below the line in the 2000 FERC Form 1, page 117, line 37 balance of \$85,035,905.
24. The Uniform System of Accounts (USOA) prescribes that account 924, Property Insurance, records shall be kept so as to show the amount of coverage for each class of insurance carried, the property covered, and the applicable premiums. Any dividends distributed by mutual insurance companies shall be credited to the accounts to which the insurance premiums were charged.
25. Based on my review of the USOA, GAAP, as applied to regulated utilities and my experience and familiarity with utility industry practices, the proper accounting treatment for the refunds from the insurance carriers would have been to reduce

account 924 by the refunds, and record the refund above the line, as had been Duke's policy prior to December 1998. Unless the regulator had ordered or permitted a different accounting treatment. This practice ensures that the true cost of service is reflected in the financial reports provided to regulators.

26. I have reviewed Duke's explanation for its decision to reclassify the refunds as miscellaneous non-operating income as set forth in its August 28, 2001 report to the commissions. Duke contends that the reclassification was appropriate because the refunds were not income associated with the providing of electric power. Although the refunds should not be recorded as operating revenue, they should have been recorded as a credit to above the line operating expenses. The USOA is clear in its direction that a refund must be credited to the account from which the premium was charged. Failing to follow this direction, as Duke did, results in an overstatement of operating expenses associated with the payment of nuclear insurance premiums.
27. The August 28, 2001 report also states that treating the refunds as miscellaneous non-operating income was appropriate because ratepayers received the "full value" of the cost of the premium. The value associated with the insurance coverage was the net cost, *i.e.* the premiums minus the refunds. See USOA 18 C.F.R. part 101(9)(defining cost as the amount of money actually paid for property or services). Because the refund was credited to Duke as below the line income, the ratepayers did not receive any credit against their premium payment. As a result, the ratepayers overpaid for the insurance coverage Duke claims they received.
28. I have also reviewed the affidavit of John J. Gillen, in which he contends, at paragraph 16(c), that "the increased NEIL Distributions were primarily comprised of large investment returns and investment growth earned by NML and NEIL." Even if Duke recognized the refunds as investment returns from the beginning, the matching concept, as embodied in GAAP and the USOA would require that the premium payments and refunds both be recorded as below the line items. Instead, as stated above, Duke recorded the premium payments above the line, and the refunds below the line. In addition, Duke's treatment of the refunds as operating income in its annual report filed with the SEC and for the purpose of calculating bonuses, suggests that management did not consider the refunds as a return on its investment.
29. I also disagree with Mr. Gillen's statement, in paragraph 16(d) of his affidavit, that Duke and its investors "shared the risk of potential loss" The insurance premiums that caused the refunds were charged above the line and, as such, were funded by the ratepayers. Accordingly, the risks and rewards related to the insurance premiums should be associated with the ratepayers. Because Duke and its investors received the entire refunds as below the line income, they received the upside rewards without bearing the downside costs – the premium payments – that accompany risk. Indeed, I am not aware of any evidence that suggests the payment of future premiums would have occurred below the line.

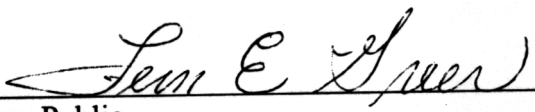
30. For these reasons, I disagree with Mr. Gillen's conclusion, set forth in paragraph 16(e) of his affidavit, that the refunds were a return on Duke's investment and that Duke's accounting treatment of them was appropriate. To the extent that one wishes to view premium payments as an "investment," the investment was made by ratepayers, who should have, but did not, receive a return on their investment.
31. Based on the facts cited above, Duke Power's accounting for 1998, 1999 and 2000 Neil,ANI,MAELU and NML distributions as items of miscellaneous non-operating income in FERC account 421, is not an acceptable accounting treatment.

I declare, under penalty of perjury, that the foregoing is true and correct. Executed this 25th day of September, 2002.


Martin J. Coe

State of Illinois
County of Rock Island

On September 25, 2002, personally appeared before me, who is personally known to me to be the signer of the above instrument, and he acknowledged he signed it.


Notary Public

